NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

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James R. Kamm, Tax Commissioner
Nebraska Department of Revenue
P.O. Box 94818
Lincoln, NE 68509-4818

Dear Mr. Kamm:

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Nebraska (State), as of and for the year ended June 30, 2024, and the related notes to the financial statements, which collectively comprise the State's basic financial statements, and have issued our report thereon dated December 18, 2024. In planning and performing our audit of the financial statements, we considered the State's system of internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the State's internal control. Accordingly, we do not express an opinion on the effectiveness of the State's internal control.

In connection with our audit as described above, we noted certain internal control or compliance matters related to the activities of the Nebraska Department of Revenue (Department) or other operational matters that are presented below for your consideration. These comments and recommendations, which have been discussed with the appropriate members of the Department's management, are intended to improve internal control or result in other operating efficiencies.

Our consideration of internal control was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as discussed below, we identified a certain deficiency in internal control that we consider to be a material weakness.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. We consider Comment Number 1 (Financial Statement Errors) to be a material weakness.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

This comment will also be reported in the State of Nebraska's Statewide Single Audit Report Schedule of Findings and Questioned Costs.

Draft copies of this management letter were furnished to the Department to provide management with an opportunity to review and to respond to the comments and recommendations contained herein. All formal responses received have been incorporated into this management letter. *Government Auditing Standards* require the auditor to perform limited procedures on the responses. The responses were not subjected to the other auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them. Responses that indicate corrective action has been taken were not verified at this time, but they will be verified in the next audit.

The following are our comments and recommendations for the year ended June 30, 2024.

1. Financial Statement Errors

The Auditor of Public Accounts (APA) identified substantial errors in the recording of financial information into the accounting system and in the accrual entries submitted to the Department of Administrative Services – State Accounting Division (State Accounting), resulting in materially misstated financial statement entries, requiring significant adjustments, revisions, and additional time to complete required audit procedures.

Errors Requiring Correcting Entries

The APA identified certain errors in the recording of locally assessed taxes and related receivables and payables. The APA inquired as to whether these taxes should be recorded in a custodial fund and not as tax revenue of the State.

State Accounting made **$923 million** in reclassification entries to classify correctly locally assessed taxes in a custodial fund.

Description	Reason	Dollar Error
Item #1: Municipal Tax Errors	The Department failed to record the locally assessed portion of certain taxes (and related receivables and payables) in a custodial fund, as required by accounting standards.	**$ 923,793,987**

The Department also made more than **$300 million** in accounting errors that resulted in the need for adjusting journal entries. The table below summarizes these issues.

Description	Reason	Dollar Error
Item #2: Municipal Tax Reclassification Entry	In its attempt to correct the issue addressed in **Item #1**, above, the Department failed to reclassify accurately the local portion of taxes payable.	$ 279,571,766
Item #3: Taxes Receivable Accrual Errors	The Department failed to accrue accurately certain tax receipts received after the fiscal year-end for the tax periods of June 2024 and prior. Additionally, the Department failed to accrue properly for corporate income tax extension payments received in July and August 2024 applicable to the March 2024 tax period.	$ 13,771,192
Item #4: Nameplate Capacity Tax Errors	The Department failed to record properly Nameplate Capacity Taxes as a tax revenue and disbursement.	$ 13,072,542
Item #5: Taxes Payable Accrual Entry	The Department failed to accrue properly for a fiduciary tax return of a taxpayer.	$ 5,315,140
	Total Adjusting Journal Entries	**$ 311,730,640**

The errors above resulted in over $1.2 billion in adjustments or reclassification of activity and are explained in more detail below.

Item #1 – Municipal Tax Errors
The APA determined that certain municipal (local) tax activity should be reclassified and reported in a custodial fund. A custodial fund generally reports fiduciary activities that are not held in a trust or equivalent arrangement that meets specific criteria, including when the government controls the assets, and whether the assets are derived from the government's own-source revenues.

In these cases, the State authorized a local government to levy a tax. The local government's tax is remitted to the State but will be distributed to the municipality for its use.

Below is a summary of the adjustments needed by tax category:

Description		Dollar Error
Local Sales and Use Taxes		
FY 2023 Activity	Fiscal Year 2023 activity was adjusted to reduce the revenues for activity that would have been accounted for in a custodial fund in the previous year.	$ 105,565,256
FY 2024 Beginning Balance	Fiscal year 2024 beginning balance was reclassified to the custodial fund.	$ 7,736,523
FY 2024 Activity	Fiscal year 2024 local taxes collected and distributed were reclassified to the custodial fund.	$ 606,267,115
FY 2024 Receivable Accrual	Fiscal year 2024 local taxes receivable were reclassified to the custodial fund.	$ 52,594,694
FY 2024 Payable Accrual	Fiscal year 2024 local taxes payable were reclassified to the custodial fund.	$ 43,999,906
Total Local Sales and Use Tax Errors		**$ 816,163,494**
Local Motor Vehicle Sales Taxes		
FY 2024 Activity	Fiscal year 2024 local taxes collected and distributed were reclassified to the custodial fund.	$ 56,236,853
FY 2024 Receivable Accrual	Fiscal year 2024 local taxes receivable were reclassified to the custodial fund.	$ 4,911,211
FY 2024 Payable Accrual	Fiscal year 2024 local taxes payable were reclassified to the custodial fund.	$ 5,296,044
Total Motor Vehicle Sales Tax Errors		**$ 66,444,108**
Local Lodging Taxes		
FY 2024 Activity	Fiscal year 2024 local taxes collected and distributed were reclassified to the custodial fund.	$ 29,374,006
FY 2024 Receivable Accrual	Fiscal year 2024 local taxes receivable were reclassified to the custodial fund.	$ 3,444,105
FY 2024 Payable Accrual	Fiscal year 2024 local taxes payable were reclassified to the custodial fund.	$ 2,798,576
Total Lodging Tax Errors		**$ 35,616,687**
Other Local Taxes – Consumers Use Tax, ATV Sales Tax, and Motorboat Sales Tax		
FY 2024 Beginning Balance	Fiscal year 2024 beginning balance related to local taxes was reclassified to the custodial fund.	$ 250,978
FY 2024 Activity	Fiscal year 2024 local taxes collected and distributed were reclassified to the custodial fund.	$ 863,560
FY 2024 Receivable Accrual	Fiscal year 2024 local taxes receivable were reclassified to the custodial fund.	$ 1,359,912
FY 2024 Payable Accrual	Fiscal year 2024 local taxes payable were reclassified to the custodial fund.	$ 3,095,248
Total Other Local Tax Errors		**$ 5,569,698**
Grand Total		**$ 923,793,987**

These reclassifications of the municipal taxes were completed by State Accounting after consultation with the APA. They are not included as adjusting entries to the financial statements; however, the entries were a direct result of the APA's inquiries.

Item #2 – Municipal Tax Reclassification Errors

In addition to the reclassification entries included above in **Item #1**, the Department failed to report accurately the local portion of the tax payables. The Department provided this correct information to State Accounting on its original submission of its accrual response form. However, when calculating the payables related to the reclassification entries from above, the Department provided a different local tax payable amount that was recorded by State Accounting

After the APA questioned the payable amounts, the Department agreed that the amounts were inaccurate. The APA proposed, and State Accounting posted, the following adjustments.

Entry	Purpose	Dollar Error
Entry #1	The fiscal year 2024 sales tax refunds payable to cities was incorrect. The actual error of $52,585,525 was compounded by its inclusion in the general fund and custodial funds as well as different object accounts.	$ 157,756,275
Entry #2	Because the taxes were not recorded as custodial activity in fiscal year 2023, a beginning balance adjustment was necessary to correct the overstated receivable and payable in the general fund.	$ 57,275,226
Entry #3	This adjustment was made to correct the fiscal year 2023 payable for the local portion of sales and use tax refunds.	$ 56,204,740
Entry #4	The Department failed to report a fiscal year 2024 payable for the Consumer Use Tax. The original $2,421,680 was compounded by its inclusion in the general fund and custodial funds as well as different object accounts.	$ 7,265,040
Entry #5	The Department failed to report a fiscal year 2023 payable for the local portion of the Consumer Use Tax.	$ 1,070,485
	Grand Total	**$ 279,571,766**

Item #3 – Taxes Receivable Accrual Entry Errors

The Department is responsible for determining the amount of taxes receivable at fiscal year-end – that is, those taxes for a tax period of June 2024 or prior – that are received after June 30. The amount is reported to State Accounting for its use in the preparation of the State's Annual Comprehensive Financial Report (ACFR).

The Department failed to include properly significant taxes received from July through September for tax periods of June 2024 and prior. After APA inquiry regarding this topic, State Accounting made the following entries:

Entry	Purpose	Dollar Error
Entry #1	The Department failed to include significant receipts for Corporate Income Tax extensions in its receivable calculation.	$ 4,253,118
Entry #2	The Department failed to include September receipts in its calculation of the State portion of Sales and Use Taxes Receivable.	$ 3,396,341
Entry #3	The Department failed to include September receipts in its calculation of the Name Capacity Taxes Receivable. The actual error of $1,636,683 was compounded by its inclusion in different object accounts.	$ 3,273,366
Entry #4	The Department failed to include September receipts in its calculation of the local portion of Sales and Use Taxes Receivable. The original $778,477 error was compounded by its inclusion in different object accounts.	$ 1,556,954
Entry #5	The Department failed to include September receipts in its calculation of the State portion of Motor Vehicle Sales Taxes Receivable.	$ 960,643
Entry #6	The Department failed to include September receipts in its calculation of the local portion of Motor Vehicle Sales Taxes Receivable. The original $165,385 error was compounded by its inclusion in different funds and object accounts.	$ 330,770
	Total	**$ 13,771,192**

Item #4 – Nameplate Capacity Tax Errors

The purpose of the nameplate capacity tax is to replace property taxes that are currently imposed on renewable energy infrastructure and are fully distributed to the counties in which the taxes were collected. Since this is a State-imposed tax, the activity should be recorded as a tax revenue and disbursement to counties, but it was recorded using a liability account.

After inquiry with State Accounting, the following corrective entries were made:

Category	Description	Dollar Error
FY 2024 Activity	Fiscal year 2024 activity was reclassified as tax revenue and disbursements to counties.	$ 12,004,298
FY 2024 Receivable Accrual	The fiscal year 2024 nameplate capacity tax receivable was also reclassified to the proper accounts. The original $534,122 error was compounded by its inclusion in different object accounts.	$ 1,068,244
	Grand Total	**$ 13,072,542**

Item #5 – Taxes Payable Accrual Entry

The APA also found that the Department failed to accrue a payable related to a $2,657,570 tax return credit owed to a taxpayer for calendar year 2023.

The taxpayer provided the APA with a copy of its tax return for calendar year 2023. The APA determined that the taxpayer did not file the claim for a refund until August 2024, and then filed an amended return in September 2024. When notified of the finding for not including this as an accrual, the Department claimed it takes time to review the return, to verify if the property tax credits were correct before a refund is issued.

After APA inquiry regarding this topic, State Accounting made the following entry:

Entry	Purpose	Dollar Error
Entry #1	To record a payable for the property tax credit paid to a taxpayer. The original $2,657,570 error was compounded by its inclusion in both the General Fund and the Permanent School Fund.	$ 5,315,140

Other Errors Noted

In addition to the errors noted above, all of which required correcting entries, the APA also identified a number of other errors made by the Department during its preparation of accrual information provided to State Accounting as part of the year end ACFR reporting. The errors are included below:

Description of Issue
The Department's accrual of estimated corporate tax receipts was incorrect. We found that three of seven receipts tested, totaling $411,219, were for tax periods after June 2024 and were, therefore, not a receivable.
The Department's accrual of delinquent individual income tax improperly included $120,927 that existed only because the Department mistakenly applied $604,634 to the taxpayer's balance due.
The Department's accrual of delinquent partnership income tax improperly included $103,754 that was received prior to the fiscal year-end but was not applied properly to the taxpayer's account and was not delinquent at fiscal year-end.
The Department's accrual of estimated income tax received improperly included one receipt of $48,571 for a tax period after fiscal year-end.
The Department understated its accrual of Corporate Income tax receivable by $16,469 because collections for one protested audit balance was not recorded until after fiscal year-end, despite being reported as having been received prior thereto.
The Department's accrual of delinquent tax receivable improperly included $12,240 that had been paid by the taxpayer in 2015.
The Department did not calculate a reasonable collectability percentage for protested Withholding and Corporate Income tax returns, as the Department did not have access to five years of historical data.
The Department will typically not accrue interest and penalty and income tax delinquencies until a payment is made, resulting in the amounts recorded as receivable at year-end being inaccurate.
The Department used inaccurate reports to prepare the individual income tax portion of the delinquent taxes receivable accrual at year-end.

A proper system of internal controls requires procedures to ensure accurate reporting of financial information in the accounting system and to State Accounting on the accrual response forms.

The Summary Schedule of Prior Audit Findings lists the status of this finding as "corrected." Title 2 CFR § 200.511(a) (January 1, 2024) requires the auditee to prepare a summary schedule of prior audit findings. Per subsection (b)(2) of that same regulation, "When audit findings were not corrected or were only partially corrected, the summary schedule must describe the reasons for the finding's recurrence and planned corrective action, and any partial corrective action taken."

As seen throughout this comment, a lack of such procedures increases the risk of material financial statement errors going undetected. The absence of procedures also increases the audit time required to ensure financial statements are materially correct.

We recommend the Department implement procedures to ensure entries are recorded correctly in the State's accounting system, and year-end accruals are reported properly to State Accounting.

Department Response:

- *Items #1 thru #4*
  - *The Department of Revenue (DOR) places a high value on accurate financial statements. The DOR will work with DAS on reclassifications and accruals to ensure they are done properly in the future.*

- *Items #5*
  - *The Department of Revenue (DOR) verifies Property Tax Credits (PTC) claimed on income tax returns before a refund is issued. Adjustments are made to a taxpayer's refund if the taxpayer made errors on their income tax return. The DOR will ensure this taxpayer is properly reported as an accrual in the future after a review of the PTC is completed.*

2. Nebraska Advantage Act

Neb. Rev. Stat. § 77-5702 (Reissue 2018) specifies the purpose of the Nebraska Advantage Act (Act), as follows:

> *The Legislature hereby finds and declares that it is the policy of this state to make revisions in Nebraska's tax structure in order to (1) encourage new businesses to relocate to Nebraska, (2) retain existing businesses and aid in their expansion, (3) promote the creation and retention of new, quality jobs in Nebraska, specifically jobs related to research and development, manufacturing, and large data centers, and (4) attract and retain investment capital in the State of Nebraska.*

The Act allows a taxpayer involved in a qualified business to earn and use tax benefits based on investment and employment growth. Several benefits are available to participants, including refunds of sales and use taxes, refunds of income taxes, tax credits taken by companies on their tax returns, the exemption of personal property, and property tax credits.

The Department reported the following activity in its 2024 Nebraska Tax Incentives Annual Report to the Nebraska Legislature (Incentives Annual Report) issued October 31, 2024:

Category	FY 2024	Cumulative
Period Covered	7/1/2023 – 6/30/2024	1/1/2006 – 6/30/2024
Number of Qualifying Projects	280	
Number of Signed Agreements	428	
Tax Credits Earned	$327,904,780	$2,574,306,929
Tax Credits Used	$115,986,264	$1,181,902,606
Direct Sales/Use Tax Refunds on Investment	$86,912,401	$855,922,927
Personal Property Value Exempted	$4,895,359,852	$21,336,247,939
Value of Real Property Reimbursed	$316,243,282	$1,069,920,450

Below is a listing of certain terms utilized by the Department and their definitions, summarized from the Incentives Annual Report:

Investment Credit: The investment credit is calculated based on a certain percentage (depending on the tier of project) of the investment made in qualified property at the project during the attainment period and entitlement period of the project. Companies typically earn investment credits during the initial qualification audit and the subsequent annual filing of the Form 312N – *Nebraska Advantage Act Incentive Computation*. These credits can additionally be used to offset a company's income tax liability.

Compensation Credit: The compensation credit is calculated based on the number of new employees and their respective wages during the entitlement period in which the minimum required levels were met or maintained. Companies typically earn compensation credits during the initial qualification audit and the subsequent filing of the Form 312N. These credits can additionally be used to offset a company's income tax liability.

Direct Refund of Sales and Use Taxes (Direct Refund): A direct refund is a refund of State and Local sales and use taxes paid on the purchase or lease of qualified property for use at the project. Qualified property is any tangible property of a type subject to depreciation or amortization, or the components of the property, that will be located and used at the project.

Credit Refund of Sales and Use Tax Refund Using Investment and Compensation Credits (Credit Refund): This is a refund of State and Local sales and use taxes paid by the applicant on otherwise non-refundable purchases. Depending upon the tier of project, the purchases may or may not be required to be used at the project (otherwise must be used within the State). This refund uses investment and compensation credits earned in a prior year.

Personal Property Tax Exemption: Taxpayers may receive personal property tax exemption on certain types of property acquired after the date of application. The types of property qualifying for such exemption, and the length of time they are exempt, depend on the tier of project.

Real Property Tax Reimbursement Using Investment and Compensation Credits: Investment and compensation credits earned in a prior year may be used for a reimbursement from the State equal to real property taxes paid on investment and/or employment (depending on tier of project) made after the date of application through the end of the carryover period of the project.

The APA's testing was limited to refund payments issued by the State to qualified businesses – which is only a portion of the fiscal year 2024 benefits reported above. The refund payments tested would be included in the table above under Tax Credits Used and Direct Sales/Use Tax Refunds on Investments. For fiscal year 2024, the State paid the following amounts in refunds to companies in the program.

Type of Refund	Dollar Amount
Refunds of State Sales and Use Tax	$ 95,426,757
Refunds of Local Sales and Use Tax	$ 23,249,574
Refunds of Income Withholding Tax	$ 52,173,670
Total	**$ 170,850,001**

Below is a brief description of each of the types of refunds tested:

Refund of State Sales and Use Tax – Companies received a refund via direct refund or credit refund (utilizing investment or compensation credits) of State sales tax previously paid on qualifying transactions.

Refund of Local Sales and Use Tax – Companies received a refund via direct refund or credit refund of Local sales tax previously paid on qualifying transactions.

Refund of Income Withholding Tax – Companies received a refund of income withholding tax utilizing compensation credits earned in a prior year to offset their income withholding tax liability.

The APA identified several issues related to the program, which are summarized in the table below:

Items Noted	Description
Item #1 – Statutory Language	The APA has concerns regarding statutory language within the Act that merit further consideration and discussion.
Item #2 – Qualification Audits	Fourteen of 20 qualification audits reviewed during testing were not performed timely.

Items Noted	Description
Item #3 – Maintenance Audits	The APA noted that 17 of 20 projects reviewed during testing have never had a maintenance audit performed by the Department.
Item #4 – Form 312N's	The Department lacked sufficient review procedures to verify the accuracy of investment and compensation credits earned and reported on the Form 312N by participating companies.
Item #5 – Project End Dates	A total of four refunds paid to three different businesses, totaling $453,421, were paid after the apparent end of the available credits.
Item #6 – Extension Agreements	The Department entered into extension agreements with participating companies using Form 872N but lacked written policies and procedures to govern these agreements or their parameters.

Item #1 – Statutory Language

The APA identified several concerns regarding statutory language within the Act. These concerns merit further consideration and discussion by the Department and/or the Nebraska Legislature.

Participating Companies "Uninvesting" in Nebraska

The Department has paid millions in State and local sales and use tax refunds to a company who uninvested in Nebraska.

Specifically, a company acquired a project that was actively earning tax credits and closed the project upon acquisition. The closure occurred prior to the completion of the Department's qualification audit of the project, which is the process to determine whether the company qualifies for incentives.

As allowed by Neb. Rev. Stat. § 77-5728 (Cum. Supp. 2024), the acquiring company was entitled to the tax credits earned, despite closing the project for which the tax credits were earned.

If one of the purposes of the Act is to retain existing business and promote the retention of new quality jobs within the State, it is worth considering whether millions of dollars in payments to a company that closed a qualifying project is reasonable.

Allowability of Certain Sales and Use Tax Refunds

Current statutory language under the Act allows participating companies to receive refunds of sales and use tax on purchases that have little applicability towards the overall promotion of growth and investment within the State.

Neb. Rev. Stat. § 77-5726(1)(c) (Cum. Supp. 2024) states the following:

> *Credits may be used to obtain a refund of sales and use taxes under the Local Option Revenue Act, the Nebraska Revenue Act of 1967, and sections 13-319, 13-324, 13-2813, and 77-6403 which are not otherwise refundable that are paid on purchases, including rentals, for use at the project for a tier 1, tier 2, tier 3, or tier 4 project or for use within this state for a tier 2 large data center project or a tier 6 project.*

(Emphasis added.) The Department paid a refund of $913 for State sales tax paid on a catered meal and related labor that was invoiced in January 2019. Specifically, the participating company purchased 600 entrees consisting of stuffed pheasant, smoked sausage, and twice-baked potatoes, at the cost of $27 per plate, from Le Bouillon, a French restaurant in downtown Omaha, Nebraska. Such a refund is allowable under the Act, as noted above, for refunds "not otherwise refundable" for tier 2 large data center projects and tier 6 projects. However, it is questionable as to whether such an expense is necessary to promote investment and employment growth within the State.

Again, it may be worth considering whether additional parameters on these sales tax refunds should be considered by the Department and/or the Nebraska Legislature for future incentive programs.

Lack of Precise Definitions

The APA observed that terms commonly used by the Department for the administration of the Act lacked precise definitions. Specifically, the APA noted the following issues:

Carryover period – Neb. Rev. Stat. § 77-5726(1)(a) (Cum. Supp. 2024) states, in relevant part, "The last year for which credits may be used is the taxable year which includes December 31 of the last year of the carryover period." The term "carryover period" is not found in the Act outside of § 77-5726(1)(a) and is not explicitly defined anywhere within the Act. The carryover period, per the Incentives Annual Report, is the time period after the end of the entitlement period, limited by the maximum life of the project.

Maximum life – The Incentives Annual Report notes that "unlike LB775, the Act limits the maximum life of the program, effectively reducing the carryover period." The term "maximum life" does not exist in the Act and is not explicitly defined otherwise. The meaning of the term is inferred from the language of Neb. Rev. Stat. § 77-5726(1)(e) (Cum. Supp. 2024), which limits the length of the carryover period to a certain number of years after the year of application (hence the "maximum life of the project").

Credit refund – The term "credit refund" does not exist in the Act and is not explicitly defined otherwise. The meaning of the term is inferred to be refunds utilizing investment and compensation credits, as outlined in Neb. Rev. Stat. § 77-5726(1)(c) (Cum. Supp. 2024).

Investment credit – The term "investment credit" does not exist in the Act and is not explicitly defined otherwise. The meaning of the term is inferred to be the credits earned by companies outlined in Neb. Rev. Stat. § 77-5725(5)-(7) (Cum. Supp. 2024).

Compensation credit – The term "compensation credit" does not exist in the Act and is not explicitly defined otherwise. The meaning of the term is inferred to be the credits earned by projects outlined in Neb. Rev. Stat. § 77-5725(3)-(4) (Cum. Supp. 2024).

As noted above, the definitions of these terms are inferred based on language within the Act, and these inferences are often based on various separate, non-consecutive, sections within the Act. Additionally, the Act frequently relies on the statutory language of other sections of statutes for the purposes of administering the Act. References to these other sections increase the complexity and decreases the understanding of the Act.

The APA relied on the definitions outlined in the Department's Incentives Annual Report; however, those definitions are more general in nature, and statutory references for those definitions are limited.

As a result, there have been a number of instances in which the APA and the Department had differing (often significantly) interpretations of statute. The APA believes such differences in interpretation would likely not exist with clearer, more precise definitions for important terms.

Ultimately, a lack of precise definitional language in the Act increases the risk of fraud, waste, and abuse of State tax revenue due to potential misinterpretation of statute.

> We recommend the Department and/or the Legislature review the above concerns for potential changes in policies, procedures, and ultimately State statute, for both the Act and similar incentive programs.

Department Response: The Department of Revenue (DOR) does not share the same view that the statutory language referenced in this management letter with respect to the Nebraska Advantage Act is ambiguous, imprecise or needs further clarification. As far as the policy decisions as to which activities deserve benefits under the program the DOR does not take a position.

Item #2 – Qualification Audits

The process for a project to be qualified under the Act includes the company's notification to the Department that it believes it has met the required levels of investment and employment to qualify for participation in the program. At that point, the Department must review the information from the company to complete a qualification audit to confirm whether the taxpayer has attained the minimum levels of investment and employment, verify the credits earned in the attainment period, and verify the initial direct sales and use tax refund.

The APA tested 25 refund payments for 20 different companies or projects. Some companies have multiple projects. The APA found that 14 of 20 qualification audits were not performed timely. The APA reviewed the following: (1) the length of time from a company's notification to the Department to the start of the audit; and (2) the length of time to complete the audit once started.

The following five companies had qualification audits that began more than a year after the company's notification to the Department:

Company	Number of Days (Years) from Notification to Start
Company #12	1,400 (3.8)
Company #16	945 (2.6)
Company #6	877 (2.4)
Company #14	561 (1.5)
Company #4	497 (1.4)

The following 12 companies had qualification audits that took more than one year to complete after the audit start date:

Company	Number of Days (Years) from Start to Completion
Company #15	2,250 (6.2)
Company #14	1231 (3.4)
Company #8	953 (2.6)
Company #5	856 (2.3)
Company #7	771 (2.1)
Company #11	736 (2.0)
Company #18	722 (2.0)
Company #6	690 (1.9)
Company #3	652 (1.8)
Company #13	459 (1.3)
Company #10	388 (1.1)
Company #12	366 (1.0)

A variety of factors affect the timing of the start and completion of the Department's qualification audits, including, but not limited to, the size of the qualifying project, Department prioritization of certain projects, difficulties obtaining documentation from companies, and Department staff and resources.

When informed by the APA of this finding, the Department offered the following response:

There is no statutory deadline for the length of time that a qualification audit should take, since a qualification audit is determining whether a business has met the minimum required levels based on the type of project, and the level of benefits that the business earned for the audit period, there is no risk of fraud or abuse of State funds. The taxpayer has audit work done to ensure that all parts of the agreement has been met and they are entitled to benefits.

The APA is aware that no statutory deadline exists for completion of a qualification audit. However, we disagree that there is no resultant risk of fraud or abuse of State funds. Procedures to ensure the timely start and completion of a qualification audit mitigate the risk of lack of quality documentation provided by the participating company. It is worth contemplating, moreover, how an effective audit process could have a qualification audit that takes over six years to complete.

We recommend the Department work with the Legislature to determine whether its current timeline to complete qualification audits is what was intended. We also recommend the Department implement procedures to ensure that qualification audits are started and completed timely.

Department Response: There is no statutory deadline for the length of time that a qualification audit should take. Since a qualification audit determines whether a business has met the minimum required levels based on the type of project, and the level of benefits that the business earned for the audit period, there is no risk of fraud, or abuse of State funds. The taxpayer provides substantiating information to ensure that all parts of the agreement has been met and they are entitled to benefits.

APA Response: Despite the lack of a statutory deadline, the APA disagrees that untimely qualification audits pose no increased risk for fraud or abuse. The further removed that an audit is from the period tested, the greater the likelihood of adequate supporting documentation being unavailable – which necessarily heightens the potential for financial impropriety.

Item #3 – Maintenance Audits

The Department also conducts periodic maintenance audits to ensure that qualifying projects continue to maintain at least the minimum levels of investment and employment necessary for the project, and to verify the accuracy of credits reported and benefits received. Maintenance audits are an integral process of the Act, as companies that do not maintain the minimum levels of employment necessary are subject to potential reduction and repayment of benefits.

The APA found that 17 of 20 projects tested have **never** undergone a maintenance audit by the Department. During fiscal years 2023 and 2024, the following companies earned the investment and compensation credits without having undergone a maintenance audit during that period:

Company	Date of Qualification Audit	Credits Earned during FY24 (Tax Year 2023)	Credits Earned during FY23 (Tax Year 2022)	Total Credits Earned
Company #2	12/17/2020			
Company #12	11/23/2022			
Company #20	11/12/2020			
Company #10	6/14/2018			
Company #15	12/15/2022			
Company #4	6/20/2023			
Company #9	4/7/2020			
Company #16	12/6/2023			
Company #1	1/28/2019			
Company #13	12/9/2019			
Company #17	11/29/2017			
Company #8	12/20/2021			
Company #19	7/11/2018			
Company #7	5/17/2023			
Company #5	5/18/2022			
Company #3	12/29/2021			
Company #14	1/19/2022			
	Total	**$ 200,878,220**	**$ 167,807,655**	**$ 368,685,875**

Note: The APA was prohibited from showing the credits earned by company. Therefore, the dates of the qualification audits for each project are shown along with the total credits for these 17 projects.

Without the timely performance of periodic maintenance audits, the Department's ability to uncover issues related to the earning of investment and compensation credits is severely limited. Although the recapture process of the Act would allow the Department to recapture fraudulent or erroneous benefits paid, the maintenance audit is an integral part of this process.

When informed by the APA of this finding, the Department responded, in part, as follows:

> *Each of the project[s] reviewed had a 100% audit rate on the initial qualification audit. DOR conducted a maintenance audit on 3 of the 20 which is 15% audit rate. The IRS audits less than 2% of the population. The Tax Commissioner is responsible for determining the delegation of resources to adequately assess the risk to the State of Nebraska. 15% is a significant portion of the population and use of resources for a single tax program.*

The APA questions whether it is the Legislature's intent that such little maintenance audit work be performed by the Department while administering the Act. **The Department failed to verify that 85% of the companies tested maintained the required levels of investment and employment.**

Without an increase in the amount of maintenance audit work performed, there is a significant risk that companies participating in the Act could fraudulently or erroneously receive refunds and other tax benefits without maintaining the required levels of investment and employment. A proper system of internal controls requires the routine verification, through regular maintenance audit work, that all actively participating companies maintain the minimum required levels or investment and employment.

> We recommend the Department work with the Legislature to determine whether the Department's 15% rate of maintenance audits is sufficient, or additional resources are necessary for the completion of more maintenance audits in a timely manner.

Department Response: Each of the projects reviewed had a 100% audit rate on the initial qualification audit which established that they met levels in order to receive benefits. The Department of Revenue (DOR) subsequently conducted a maintenance audit on 3 of the 20 which is a 15% audit rate. For some perspective, the IRS audits less than 1% of the population of returns within its income tax program. The Tax Commissioner is responsible for determining the allocation of resources to adequately address and mitigate the risk to the State of Nebraska. An audit rate of 15% is a significant portion of the population and represents a significant commitment of resources for a single tax program.

APA Response: The APA's issue is not with the initial qualification audits; rather, it is with the lack of their subsequent maintenance counterparts. Regardless of IRS procedures, the fact remains that 17 of the 20 projects tested have not undergone a maintenance audit after the initial qualification audit. Consequently, the Department has failed to verify whether the required levels of investment or employment has continued to be met.

Item #4 – Form 312N's

The Department requires participating companies to file an annual Form 312N (Nebraska Advantage Act Incentive Computation), beginning with the filing of the application through the expiration of all incentives under the Act. If a company has more than one qualifying project, a separate Form 312N must be completed for each project.

The form includes a calculation of the compensation and investment credits earned during the year, which are then available to the companies to receive sales and use tax refunds, income tax offsets or refunds, income tax withholding offsets or refunds, or real property tax reimbursement, as requested by the companies.

The Department's procedures for reviewing investment and compensation credits earned included an examination of the pattern in FTE growth, the withholding ratio, whether Medicare wages compared to taxable wages on the W-3N, etc., but did not include tracing the actual figures reported to supporting documentation provided by the company – such procedures would occur instead during a maintenance audit. As a result, projects without maintenance audits performed (see **Item #3** above) lacked a proper review of whether the investment and compensation credits earned were verified to supporting documentation provided by the company.

A proper system of internal controls requires procedures to ensure the accuracy of the figures reported on the annual Form 312N filing and its supporting schedules.

Without such procedures, there is an increased risk of fraud, waste, and abuse of the State tax incentive program funds.

> We recommend the Department implement procedures to: 1) ensure adequate documentation exists to support figures reported on the annual Form 312N and its supporting schedules; and 2) periodically review the supporting documentation provided to ensure the accuracy of the investment and compensation credit earned.

Department Response: The Department of Revenue (DOR) does have a procedure in place that is followed when a 312N is received. The DOR does process the 312N and check for accuracy prior to it being entered into to the corresponding database. The items checked include but are not limited to the tier of the project, that the company qualified, that the lines are mathematically correct, and many other items.

APA Response: While checking the form for mathematical accuracy, the Department does not request or review supporting documentation to ensure the underlying accuracy of the information presented.

Item #5 – Project End Dates

One of the main disagreements between the Department and the APA involves whether there is an actual end date for any project under the Act. Current statutes seem to provide an end date for each project, which is the end of the carryover period of the project. Neb. Rev. Stat. § 77-5726(1)(a) (Cum. Supp. 2024) states the following, in relevant part:

> *The last year for which credits may be used is the taxable year which includes December 31 of the last year of the carryover period.*

Furthermore, § 77-5726(1)(e) states the following:

> *Credits may be carried over until fully utilized, except that such credits may not be carried over more than nine years after the year of application for a tier 1 or tier 3 project, fourteen years after the year of application for a tier 2 or tier 4 project, or more than sixteen years past the end of the entitlement period for a tier 6 project.*

(Emphasis added.) The APA interprets these statutes as providing a definite end date for the project – that is the date that credits are no longer able to be carried over. If credits are not available, it would be impossible for a company to request a credit refund after the credits have lapsed per statute.

The APA identified four payments to three companies that received credit refunds after the expiration date of their credits:

Company	Date of Payment	Project End Date	Refund Amount
Company #15	4/3/2024	12/31/2023	$ 284,656
Company #5	9/19/2023	12/31/2021	85,856
Company #5	9/19/2023	12/31/2021	76,074
Company #6	10/2/2023	12/31/2016	6,835
		Total	**$ 453,421**

The following table shows the total credit refunds made after the expiration of the credits through June 30, 2024:

Company	Project End Date	Refund Amount
Company #15	12/31/2023	$ 2,817,998
Company #5	12/31/2021	1,527,874
Company #6	12/31/2016	134,548
	Total	**$ 4,480,420**

When informed by the APA of this finding, the Department responded, in part, as follows:

> *The Nebraska Department of Revenue (DOR) files the Nebraska Tax Incentive Report annually with the Legislature where the amount of outstanding credits under the Nebraska Advantage Act (NAA) is reported. For purposes of the report, DOR does not expire any credits that are open as a result of a statute of limitations extension even though the project itself has passed the last year of the carryover period. In the Nebraska Tax Incentives 2024 Annual Report to the Nebraska Legislature (issued 10/31/2024) DOR stated: "No new Nebraska Advantage Act applications may be filed after December 31, 2020. However, benefits under the Nebraska Advantage Act may be claimed through 2051, not including extensions or legal matters that remain open." The Legislature is well aware, through the Department's reporting, that credits may be claimed in years open to the statute of limitation even though the project itself has passed the last year of the carryover period*

In the above response, the Department references a statute of limitations extension. See **Item #6** below for further discussion on these extension agreements.

The Department claims also that the Legislature is "well aware" of this practice. In truth, however, the Department only recently added the language "not including extensions or legal matters that remain open" in its 2024 Annual Report, doing so after the APA raised this issue during the fiscal year 2024 ACFR testing.

Without procedures to ensure compliance with the clear requirements of the Act, there is an increased risk for loss or misuse of the tax incentive program.

> We recommend the Department consult with the Legislature to determine whether tax credits earned pursuant to the Act have, or should have, an expiration date that would preclude participating companies from requesting further refunds.

Department Response: The statute does not provide for an end date to the project. Rather, the statute provides that credits may not be carried over for more than a certain number of years following the end of the entitlement period. The language used by the legislature is referencing the tax years in which credits may be used. If the relevant tax year is open to the statute of limitation a tax return may be filed to utilize available credits. Additionally, the Department of Revenue (DOR) files the Nebraska Tax Incentive Report annually with the Legislature where the amount of outstanding credits under the Nebraska Advantage Act (NAA) is reported. For purposes of the report, DOR does not expire any credits that are open as a result of a statute of limitations extension even though the project itself has passed the last year of the carryover period. In the <u>Nebraska Tax Incentives 2024 Annual Report to the Nebraska Legislature</u> (issued 10/31/2024) DOR stated: "No new Nebraska Advantage Act applications may be filed after December 31, 2020. However, benefits under the Nebraska Advantage Act may be claimed through 2051, not including extensions or legal matters that remain open." The Legislature is well aware, through the DOR's reporting, that credits may be claimed in years open to the statute of limitation even though the project itself has passed the last year of the carryover period. The additional language does not impact how DOR reports the data in the Annual Report, it provides an interpretation of that data.

APA Response: The statutes referenced in the comment are clear and unambiguous. We will defer to the Nebraska Legislature, however, as to whether tax credits should expire in accordance with those express statutory provisions.

<u>Item #6 – Extension Agreements</u>

Companies are typically required, per Neb. Rev. Stat. § 77-5726(2)(d) (Cum. Supp. 2024), to file claims "within three years from the end of the year the required levels of employment and investment are met." However, the Department allows companies participating in the Act to file a Form 872N – *Nebraska Extension of Statute of Limitations Agreement* – which essentially provides an unlimited amount of time for a company to file a claim as long as credits remain available to the company.

The APA noted that 14 of 20 companies tested had at least one – and in most cases more than one – extension agreement with the Department. Specifically, the APA observed the following extension agreement activity for those 14 companies:

Company	Number of Agreements	Periods Covered
Company #6	30	December 2009 - October 2023
Company #5	22	November 2014 - December 2023
Company #11	18	December 2016 - January 2023
Company #15	17	April 2017 - June 2024
Company #12	13	June 2016 - December 2023
Company #4	12	December 2017 - February 2024
Company #2	10	February 2022 - July 2024
Company #20	7	May 2020 - May 2024
Company #3	7	January 2020 - August 2022
Company #8	5	December 2019 - June 2022
Company #14	3	December 2019 - June 2021
Company #9	2	February 2023 - December 2024
Company #7	1	March 2023 - October 2023
Company #16	1	December 2023 - February 2024

During testing, the APA found that the Department lacked written policies and procedures governing the extension agreement process, including restrictions upon not only the amount of time granted by an extension agreement but also the maximum number of extension agreements allowed per requestor.

Additionally, even if permitted by statute, the Department's use of, as well as participating companies' reliance upon, these extension agreements should be carefully examined for unintended consequences. Under the Department's current procedures, the time limits set in statute effectively cease to exist – allowing companies to claim credits for an indefinite amount of time into the future.

A proper system of internal control requires written policies and procedures for all tax refund claim processes, including the use of the Form 872N to extend the time that companies are permitted to obtain benefits under the Act.

Without such written policies and procedures, there is an increased risk for not only fraud, waste, and abuse of State tax incentive program funds but also unintended consequences.

> We recommend the Department review its policies and procedures to ensure the process of issuing extension agreements through the Form 872N is subject to specific parameters consistent with legislative intent.

Department Response: The Department of Revenue (DOR) has a Delegation of Authority that determines who has the authority to enter into a Waiver or 872N as provided by 77-2708(2)(b). The DOR ensures that entering into a Waiver is in the best interest of the State of Nebraska, prior to signing of the Wavier. The DOR is working on a procedure about how waivers or 872N's are obtained.

APA Response: The APA questions whether the Department's use of the waivers, absent any guiding administrative policies and procedures, is consistent with legislative intent. The consequence of such unrestricted use is the effective elimination of any applicable time limits for using credits.

3. Homestead Exemption Disbursements

The Department paid $142,535,687 in homestead exemption property tax credits to counties. The State's Homestead Exemption property tax credit program is authorized under Neb. Rev. Stat. §§ 77-3501 through 77-3529 (Reissue 2018, Cum. Supp. 2024) and provides full or partial property tax exemption on a homestead's value to property owners.

Qualified applicants fall into one of eight categories: 1) owner occupants ages 65 and over; 2) veterans totally disabled by a non-service accident or illness; 3) disabled individuals; 4) 100% Permanently disabled veterans; 5) spouses of qualified veterans; 6) veterans with homes contributed to by the United States Department of Veterans Affairs; 7) individual who have a developmental disability; and 8) 100% temporary disabled veterans.

After all applicable reviews and verifications, the county assessor and county treasurer certify the total amount of their exemptions on a Homestead Exemption Summary Certificate Form 458S, which includes the number of exemptions, total exempt homestead property value, and the total tax loss to the county. These certificates are provided to the Department prior to November 30. The Department reimburses the counties based on the information contained on this form.

The Department lacked adequate procedures for verifying the accuracy of the tax loss reported by the counties on the Form 458S. A comparison to individual applications on a test basis was not performed; instead, the Department verified the total on the Form 458S to the total on the Certificate of Taxes Levied (CTL) for each county and compared the total amounts reported from year to year.

A proper system of internal control requires procedures for verifying the accuracy of the total tax loss reported on the Form 458S to ensure the accuracy of amounts paid to the counties. Such procedures might include a comparison, on a test basis, of records maintained by the county assessors that show which individual properties were approved for the reported tax loss, to ensure an approved application is on file at the Department.

Without such procedures, there is an increased risk for inaccurate homestead exemption payments to counties.

A similar comment was included in the prior year's management letter.

> We recommend the Department implement procedures for reviewing, on a test basis, individual properties included on the CTL reports to ensure a valid application is on file for those properties. We also recommend the Department continue its comparison of the totals from the Form 458S to the CTL reports and set thresholds for changes that require further review.

Department Response: The Department of Revenue is in the process of implementing an audit process for Homestead Exemption Reimbursement to counties.

4. Delinquent Tax Assessment

The Department failed to take action to collect delinquent sales and withholding taxes of $10,348 from one taxpayer tested.

In August 2023, the Department issued a Demand for Payment to a taxpayer for $34,764 for uncollected sales and withholding taxes. Months later, in November 2023, the Department revised the levied amount to $24,658, which was a reduction of $10,348, to allow the taxpayer the ability to pay outstanding bills to other entities, fulfill payroll obligations to its employees, and to allow the taxpayer the ability to return to Nebraska from out of state. The taxpayer paid $24,658 on November 27, 2023.

When questioned by the APA in August 2024 about the remaining $10,348 owed by the taxpayer, the Department stated that the taxpayer never returned a Form 27D – *Payment and Authorization Agreement for Electronic Funds Transfer (EFT) of Tax Payments*.

As of the end of our fieldwork in September 2024, the Department still had failed to obtain any payment plan with the taxpayer, nor had it issued a new levy against the taxpayer.

When informed by the APA of this finding, the Department responded, in part, as follows:

> *DOR disagrees with this being a risk of fraud, waste and abuse of State funds. This is a management decision, and the correct procedures and policies were followed. Taxpayers are allowed to ask DOR to take into consideration their financial situation and the ability to pay through an installment agreement, per the Taxpayer Bill of Rights.*

The Department's own "Nebraska Taxpayer Bill of Rights," Section VII, *Installment Payments of Tax Liabilities,* states the following, in relevant part:

> *Nebraska taxpayers have the right to request to pay delinquent taxes by installment, if their financial situation does not allow them to pay the balance in full. The Department will consider the financial condition of the taxpayer and the ability of the taxpayer to make installment payments. <u>If an installment agreement will facilitate collection of the delinquent taxes, the Department will enter into such an agreement with the taxpayer in accordance with established guidelines</u>.*

(Emphasis added.) Nevertheless, the Department has failed to enter into such an installment agreement with the taxpayer.

Good internal controls require procedures to ensure the full collection of taxes due, through implementation of an installment agreement if needed.

Without such procedures, there is an increased risk that the proper amount of taxes will not be collected.

> We recommend the Department review its procedures for ensuring the full amount of taxes is collected from taxpayers, following its own directive by utilizing installment agreements when necessary.

Department Response: The Department of Revenue (DOR) disagrees with this being a risk of fraud, waste, and abuse of State funds. This is a management decision, and the correct procedures and policies were followed. The DOR uses a variety of tools allowed by the Nebraska Legislature to collect delinquent taxes. These tools coupled with the Taxpayer Bill of Rights ensure there is not an abuse of power by the DOR and allows for the Taxpayers of the State of Nebraska to work with the DOR to find a resolution to their delinquencies. Taxpayers are allowed to ask the DOR to take into consideration their financial situation and the ability to pay through an installment agreement, per the <u>Taxpayer Bill of Rights</u>.

APA Response: The response provided evades the primary issue – namely, that the Department has failed to use the tools available, including installment agreements, to obtain the delinquent funds to which the State is entitled. Taking the appropriate remedial action does not constitute an "abuse of power," as posited in the response. To the contrary, such action is merely exercising proper stewardship over public monies owed.

5. <u>Mainframe Application Issues</u>

The Department utilizes multiple mainframe applications for tax revenues and refunds. Individual income tax refund payments are automatically interfaced and prepared, approved, and posted within the State's accounting system. However, in rare situations, when transactions do not post automatically in the accounting system, Department staff are required to post the interfaced transactions manually. Access to perform this function is given to staff with a certain accounts payable role in the accounting system (AP20 or higher) in addition to having access to the accounting system's Batch Management process.

The APA found five users with elevated access in the individual income tax system who also had access to AP20 or higher and Batch Management access in the accounting system. While other compensating controls have been implemented to reduce the risk, these users still had system access to create or adjust a return within the individual

income tax system and approve and post batches in the accounting system. Furthermore, these same individuals are on the team that performs refund reconciliations between individual income tax system and the accounting system. These five users had their individual income tax system access removed on May 14, 2024, after inquiry by the APA.

The Department uses the General Processing System (GPS) for handling smaller taxes and fees collected and refunded. The APA found 11 users with elevated access to the GPS system that was unreasonable based on their current job duties. In each of these cases, the employee either terminated or changed jobs, and the elevated access to GPS was not removed. For nine of these users, the access to active directory (their State account) and the mainframe was removed timely as part of the Department's quarterly access review, but the elevated GPS access was not. For the remaining two employees, the GPS access was not removed timely despite being requested to be removed in October 2023.

Nebraska Information Technology Commission (NITC) is a nine-member Commission established by the Nebraska Legislature that provides advice, strategic direction, and accountability on information technology investments in the State. The NITC has adopted Technical Standards and Guidelines, Information Security Policy 8-303(4) (November 2022), "Identification and authorization," which states the following:

> *To reduce the risk of accidental or deliberate system misuse, separation of duties must be implemented where practical. Whenever separation of duties is impractical, other compensatory controls such as monitoring of activities, increased auditing and management supervision must be implemented. At a minimum, the audit of security must remain independent and segregated from the security function.*

NITC Technical Standards and Guidelines, Information Security Policy 8-502 (July 2023), "Minimum user account configuration," states the following, in relevant part:

> *User accounts must be provisioned with the minimum necessary access required to perform duties. Accounts must not be shared, and users must guard their credentials.*

NITC Technical Standards and Guidelines, Information Security Policy 8-701 (July 2023), "Auditing and compliance; responsibilities; review," states the following, in relevant part:

> *An agency review to ensure compliance with this policy and applicable NIST SP 800-53 security guidelines must be conducted at least annually.*

A proper system of internal controls requires an adequate segregation of duties, where practical, to ensure that no one individual is in a position both to perpetrate and to conceal errors or irregularities. If adequate segregation is not possible, other compensating controls should be implemented. A proper system of internal controls would also require procedures to ensure that user access to the Department's systems is limited to individuals who need it to fulfill their job duties, and such access is removed in a timely manner when no longer needed.

Without such procedures, there is an increased risk of not only inappropriate access to State assets and resources, as well as the unauthorized processing of transaction, but also noncompliance with applicable regulations and standards.

> We recommend the Department implement procedures to ensure an adequate segregation of duties exists. We further recommend the Department implement procedures to ensure that user access to its systems is limited to individuals who need it to fulfill their job duties, and such access is removed in a timely manner when no longer needed.

Department Response: The Department of Revenue has reviewed its procedures and will not grant certain access to staff with AP20 or higher access.

* * * * *

It should be noted that this letter is critical in nature, as it contains only our comments and recommendations and does not include our observations on any strengths of the Department.

Our audit procedures were designed primarily to enable us to form an opinion on the Basic Financial Statements. Our audit procedures were also designed to enable us to report on internal control over financial reporting and on compliance and other matters based on an audit of financial statements performed in accordance with *Government Auditing Standards* and, therefore, may not bring to light all weaknesses in policies or procedures that may exist. Our objective is, however, to use our knowledge of the Department and its interaction with other State agencies and administrative departments gained during our work to make comments and suggestions that we hope will be useful to the Department.

The purpose of this letter is solely to describe the scope of our testing of internal control over financial reporting and compliance and the result of that testing, and not to provide an opinion on the effectiveness of State's internal control over financial reporting or compliance.

This communication is intended solely for the information and use of management, the Governor and State Legislature, others within the Department, Federal awarding agencies, pass-through entities, and management of the State of Nebraska and is not suitable for any other purposes. However, this communication is a matter of public record, and its distribution is not limited.

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